

**Minutes
State Board of Investment
May 29, 2014**

The State Board of Investment (SBI) met at 9:00 A.M. Thursday, May 29, 2014 in Room 112, State Capitol, St. Paul Minnesota. Governor Mark Dayton, State Auditor Rebecca Otto, Secretary of State Mark Ritchie and Attorney General Lori Swanson were present. The minutes of the March 4, 2014 meeting were approved.

Executive Director's Report

Mr. Perry, Executive Director, referred members to Tab A of the meeting materials. He reported that the Combined Funds had outperformed its Composite Index over the ten-year period ending March 31, 2014 (Combined Funds 8.0% vs. Composite 7.7%) and had provided a real rate of return over the latest 20-year period (Combined Funds 8.8% vs. CPI 2.4%).

Mr. Perry said that the Combined Funds' assets increased 1.1% for the quarter ending March 31, 2014 due to positive market performance. He said the asset mix was on target, and he stated that the Combined Funds matched its Composite Index for the quarter (Combined Funds 2.1% vs. Composite 2.1%), and outperformed for the year (Combined Funds 15.6% vs. 14.3%) and over longer periods.

Mr. Perry reported that the domestic stock manager group outperformed its target for the quarter (Domestic Stocks 2.1% vs. Target 2.0%), for the year (Domestic Stocks 24.1% vs. Target 22.6%) and most remaining time periods. He said the international stock manager group underperformed its target for the quarter (International Stocks 0.2% vs. Target 0.5%) but outperformed for the year (International Stocks 13.4% vs. Target 12.3%) and all remaining time periods. Mr. Perry stated that the bond segment outperformed its target for the quarter (Bonds 2.0% vs. Target 1.8%), for the year (Bonds 0.5% vs. Target -0.1%) and all remaining periods. He concluded his report with the comment that, as of March 31, 2014, the SBI was responsible for close to \$75 billion in assets under management.

Mr. Perry referred members to Tab B of the meeting materials and noted that the SBI recurring budget and travel expenses were in-line with expectations. He then gave a legislative update of issues relevant to the SBI. Mr. Perry stated that the merger of Duluth Teachers Retirement Fund Association into the Teachers Retirement Association had passed and he anticipated that the Duluth assets would be transferred to the SBI by calendar year end. Mr. Perry noted that the SBI had received legislative authority for greater investment option flexibility within the various state defined contribution plans as well as the Supplemental Investment Fund (SIF.)

Next, Mr. Perry discussed the Women's Economic Security Act, (WESA) which had been signed into law. He stated that the SBI sought and received an exemption from the pay equity certificate requirement of WESA for its Deferred Compensation Plan investment manager contracts. He noted that all other SBI contracts would need to comply with this requirement going forward. Mr. Perry stated that WESA also required that a study on the potential development of a state administered retirement savings plan be completed by Minnesota

Management and Budget (MMB.) The goal of such a savings plan would be to provide a retirement savings vehicle for employees in the state of Minnesota who had limited access to traditional savings methods. He noted that the SBI would work with MMB on the investment component of this study.

Mr. Perry shared that the SBI worked with the State Auditor's Office on a bill to enhance statewide OPEB reporting to the State Auditor's Office. He concluded Tab B by referring members to the Iran and Sudan updates and he noted there was no litigation at this time.

Mr. Perry then announced that Jim Heidelberg, current Assistant Executive Director, would be retiring in July 2014. Ms. Otto expressed appreciation to Mr. Heidelberg for his exemplary, long-term service to the state and noted that he would be missed.

Ms. Hacking referred members to Tab C and presented the report from the SBI Administrative Committee meeting of April 30, 2014 with four items for approval. She stated that Administrative Committee was recommending approval of the first item, the Executive Director's Proposed Workplan for FY 2015. There were no questions on the workplan.

Ms. Hacking also reviewed the SBI Budget Plans for FY14, FY15 and FY16 administrative budgets. She explained that the FY15 and FY16 budget requests represented large increases over previous years because of the request for five additional staff. Of the five additional staff, she noted that three would be investment professionals and two would be dedicated to the accounting area. She said that the Administrative Committee felt the staff increase was warranted because of the growth of assets under management and the greater complexity surrounding investments. She also noted that that Governmental Accounting Standards Board was requiring implementation of difficult and complex accounting standards, causing a need for increased accounting staff. Ms. Hacking stated that independent studies had previously concluded that the SBI was thinly staffed relative to peers. Ms. Hacking reminded the board that the funds requested were coming from the retirement systems, and all three retirement boards had already met and approved the additional SBI spending. She then requested the needed approval for the proposed workplan and budget. Mr. Ritchie moved adoption of the first two recommendations as stated in Tab C of the meeting materials which reads **"The Committee recommends that the SBI approve the FY15 Executive Director's Workplan. Further, the Committee recommends that the Workplan serve as the basis for the Executive Director's performance evaluation for FY15. The Committee recommends that the SBI approve the FY14, FY15, and FY16 Administrative Budget Plan, as presented to the Committee, and that the Executive Director have the flexibility to reallocate funds between budget categories if the Executive Director deems necessary."** After a brief discussion the motion passed.

Ms. Hacking introduced the third item for approval, the review of the Continuing Fiduciary Education Plan. She explained that it was straightforward and adopted annually, but required a separate motion. Mr. Ritchie moved adoption of recommendation three, as stated in Tab C of the meeting materials which reads **"The Committee recommends that the SBI adopt the attached Continuing Fiduciary Education Plan"**. The motion passed.

Ms. Hacking introduced the final item for approval, the review of Executive Director's Evaluation and Salary Process. She recommended that the salary and review process be completed prior to the September 2014 SBI meeting. Mr. Ritchie moved adoption of recommendation four, as stated in Tab C of the meeting materials which reads **"The Committee recommends that the SBI adopt the following process for the Executive Director's FY14 performance evaluation:**

- **The evaluation will be completed prior to the September 2014 meeting of the SBI and will be based on the results of the Executive Director's workplan for FY14.**
- **The SBI deputies/designees will develop an appropriate evaluation form for use by each member, which will reflect the categories in the Executive Director's position description and workplan.**
- **Governor's office will coordinate distribution and collection of the evaluation forms and will forward the completed forms to the Executive Director. Board members are encouraged to meet individually with the Executive Director to review their own evaluation."** The motion passed.

Mr. Bailey then spoke on behalf of the Investment Advisory Council. He recommended that the SBI approve the termination of Turner Investments, L.P. He reviewed the rationale for termination, which included significant performance problems and high portfolio manager and analyst turnover at the firm. Ms. Otto moved approval of the recommendation, as stated in Tab D of the meeting materials, which reads **"Due to significant staff departures, loss of firm assets and continued long- and short-term underperformance, staff and the IAC recommend that the SBI terminate the relationship with Turner Investments, L.P."** The motion passed.

Mr. Bailey then relayed to the board key discussion items from the latest IAC meeting. First, Mr. Bailey discussed the manager vetting process within the IAC, and alternative investment managers in particular. He stated that going forward, the IAC's public and alternative assets manager-vetting process would focus on staffs' due diligence process. The IAC found this more beneficial than guest presentations from private equity managers. Second Mr. Bailey relayed that the IAC had a lengthy discussion on the unallocated portion of alternative investments, and that after much debate among IAC members, the current policy of holding the funds in fixed income was decided to be the most appropriate approach.

Mr. Bailey then referred members to Tab E of the meeting materials and briefly reviewed investments with one existing resource manager (Merit Energy) and one existing private equity manager (Banc Funds). Mr. Ritchie moved approval of both recommendations in Tab E of the meeting materials, which reads **"The Investment Advisory Council concurs with staff's recommendation that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$125 million, or 20% of Banc Fund IX, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota,**

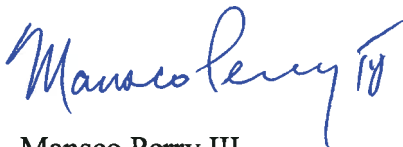
the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by Banc Funds upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on Banc Funds or reduction or termination of the commitment.”

“The Investment Advisory Council concurs with staff’s recommendation that the SBI authorize the Executive Director, with assistance from the SBI’s legal counsel, to negotiate and execute a commitment of up to \$200 million, or 20% of Merit I, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by Merit upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on Merit or reduction or termination of the commitment. The motion passed.

Governor Dayton asked how the SBI evaluated managers given that performance between the best and worst performing managers varied by a wide margin. Mr. Bailey responded that past performance was only one of many factors taken into account during manager evaluation. He noted that the best evaluations focused on the manager’s consistency with the investment philosophy and process that resulted in the initial hiring of the manager. Mr. Perry then commented that the SBI reviewed the manager’s organization and performance and that five years was often too short of a time to know if a manager’s value-add proposition was working. Mr. Ritchie asked if the SBI’s rate of manager dismissal was appropriate. Mr. Bailey responded that because terminating managers is expensive, the SBI’s patient approach with fewer terminations over time has served the State well. Ms. Otto confirmed the importance of the thoughtful approach to manager review and termination and she noted that the SBI’s lower rate of manager turnover has resulted in the SBI being a more conservative, steady organization than many of its peers.

The meeting adjourned at 9:42 A.M.

Respectfully submitted,



Mansco Perry III
Executive Director